

# CRS Report for Congress

## Malaysia: Political, Security, Economic, and Trade Issues Considered

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# Malaysia: Political, Security, and Economic Issues Considered

## Summary

This report discusses key aspects of the U.S.-Malaysia relationship, including economics and trade, counterterrorism cooperation, defense ties, and Malaysia's external posture as it affects American interests. The bilateral relationship is generally positive and constructive, particularly in the area of trade. Malaysia is a key trading partner of the United States and is regarded as an effective and cooperative regional player in the war against terror. The United States and Malaysia also have informal defense ties including commercial access to Malaysian ports and repair facilities. Despite these positive dynamics, the bilateral relationship has at times been strained. Past differences have stemmed from disagreements between Malaysia's former Prime Minister Mahathir Mohamad and the United States over such issues as the internal suppression of dissent in Malaysia, the Israeli-Palestinian conflict, Iraq, globalization, Western values, and world trade policy. Relations are perceived as having improved since Abdullah Badawi became prime minister in 2003.

After years of strong economic growth, Malaysia has become a middle income country. Much of its gain in economic prosperity has come from the export of electronics and electrical products, with the United States as its top export market. According to U.S. trade figures, Malaysia exports nearly \$35 billion of goods each year to the United States and imports over \$11 billion from the United States.

The United States and Malaysia have enjoyed a positive trade relationship over the last few years, in part because both nations favor trade and investment liberalization in Asia. Malaysia is the United States' 10<sup>th</sup> largest trading partner. Building on their common perspective of international trade, Malaysia and the United States concluded a trade and investment framework agreement in 2004 and are currently negotiating a bilateral free trade agreement. Key issues still to be resolved in the negotiations principally revolve around market access for key goods and services in both the United States and Malaysia, and intellectual property rights protection in Malaysia.

The free trade agreement negotiations have been complicated by Malaysia's \$16 billion energy deal with Iran to develop Iranian natural gas fields and related infrastructure. The January 2007 Malaysia-Iranian deal has led to opposition by some members of Congress. Chairman Lantos of the House Committee on Foreign Affairs sent a letter to U.S. Trade Representative Susan Schwab calling for the Malaysian-Iranian deal to be nullified before the U.S. proceeds with free trade negotiations. This report will be updated as circumstances warrant.

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# Malaysia: Political, Security, and Economic Issues Considered

U.S. relations with Malaysia are generally positive. Both countries share interests in maintaining regional stability, countering terrorism, dealing with militant Islam, developing close trade and investment relationships, securing the safety of ships passing through the Strait of Malacca, and establishing mutually beneficial military cooperation. Since coming to power in 2003, Malaysian Prime Minister Abdullah Badawi has provided opportunities for the United States to improve diplomatic and political relations with this Southeast Asian nation. Malaysia is a moderate secular Islamic nation whose experience and cooperation could play a key role in coping with Islamic extremism, countering terrorism, and exerting a moderate influence on the Islamic community in Southeast Asia. This report provides an overview of recent political and economic developments in Malaysia, and examines implications for U.S. policy in terms of bilateral trade, military cooperation, and counterterrorism cooperation.

## Recent Developments

### Malaysia-Iran Ties and the FTA

On March 8, 2006, the United States and Malaysia announced they would begin negotiating a bilateral free trade agreement (FTA).<sup>1</sup> The announcement was made by ex-U.S. Trade Representative Rob Portman and Malaysia's Minister of International Trade and Industry Rafidah Aziz on Capitol Hill with a bipartisan group of Members of Congress in attendance. The stated goals for the proposed FTA were to remove tariff and non-tariff trade barriers, and expand bilateral trade.

Since the announcement, The United States and Malaysia have held five rounds of negotiations concerning the terms of the proposed FTA.<sup>2</sup> The fifth round of talks were scheduled to be held in Malaysia on February 5-8, 2007. Among the outstanding issues in the negotiations are: (1) market access for U.S. exports to Malaysia of agricultural goods, automobiles, and automotive parts and components; (2) market access for Malaysian exports to the United States of agricultural goods; (3) market

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<sup>1</sup> "United States, Malaysia Announce Intention to Negotiate Free Trade Agreement," U.S. Trade Representative's website: [[http://www.ustr.gov/Document\\_Library/Press\\_Releases/2006/March/United\\_States,\\_Malaysia\\_Announce\\_Intention\\_to\\_Negotiate\\_Free\\_Trade\\_Agreement.html](http://www.ustr.gov/Document_Library/Press_Releases/2006/March/United_States,_Malaysia_Announce_Intention_to_Negotiate_Free_Trade_Agreement.html)].

<sup>2</sup> For details about the proposed FTA and its negotiation, see CRS Report RL33445, *The Proposed U.S.-Malaysia Free Trade Agreement*, by Michael F. Martin.

access for U.S. services, especially financial services, in Malaysia; (4) Malaysia's enforcement of intellectual property rights (IPR) protection; and (5) Malaysia's government procurement system and its preferential treatment for businesses owned and operated by ethnic Malays, or *bumiputera*.

Conditions for the fifth round of talks were complicated at the end of January with the news of a \$16 billion energy development deal between Malaysia's SKS Group and the National Iranian Oil Company that would develop Iranian gas fields and build liquefied natural gas plants.<sup>3</sup> Over the last six years, trade between Iran and Malaysia has grown rapidly. According to Malaysia's Department of Statistics, total trade between Malaysia and Iran rose from \$224 million in 2000 to over \$765 million in 2005. Although precise data was not provided, an official press release by Malaysia's Ministry of International Trade and Industry (MITI) specifically mentioned Iran as one of the nations with which Malaysia's trade increased "significantly" in 2006.

During a House Committee on Foreign Affairs Hearing on January 31, 2007, Chairman Tom Lantos (Democrat, California) called the deal "abhorrent," and sent a letter to U.S. Trade Representative Susan Schwab requesting the suspension of negotiations on the proposed FTA until Malaysia renounced the deal with Iran.<sup>4</sup> U.S. Trade Representative Schwab indicated that she intended to continue the negotiations with Malaysia.<sup>5</sup>

Malaysia sharply rejected the call to revoke the energy deal with Iran. Malaysia's Minister of International Trade and Industry Seri Rafidah Aziz reportedly stated that the United States has no right to block Malaysia trading with any country, even after the conclusion of the proposed FTA.<sup>6</sup> Malaysia's Prime Minister Badawi

### Malaysia In Brief

**Population:** 25.6 million, growth rate 1.7% (2006 est)  
**Area:** 127,316 sq. miles (about the size of New Mexico)  
**Capital:** Kuala Lumpur  
**Ethnic Groups:** Bumiputeras 58% [Malay 47%, Indigenous 11%], Chinese 24%, Indian 7%, Non-citizens 7% others 4%  
**Literacy:** 94%  
**Religion:** Muslim, Buddhist, Confucian, Taoist, Christian, Hindu, Sikh, Baha'i  
**GDP growth:** 5.8% (2006 est)  
**Per capita GDP:** \$11,871 purchasing power parity (2006 est.)  
**Unemployment:** 3.5% (2006 est.)  
**Inflation:** 3.7 % (2006)  
**Natural Resources:** Petroleum, natural gas, tin, minerals, palm oil, rubber  
**U.S. Trade:** Malaysia is the United States' 10<sup>th</sup> largest trade partner  
**Sources:** U.S. Department of State, CIA World Fact Book, Economist Intelligence Unit, Global Insight

<sup>3</sup> "Malaysia Stands by Iranian Gas Deal," *BBC News*, February 2, 2007.

<sup>4</sup> "Remarks by Congressman Tom Lantos, Chairman, House Committee on Foreign Affairs, at Hearing, 'Understanding the Iran Crisis,'" January 31, 2007.

<sup>5</sup> Reported in *Washington Trade Daily*, February 5, 2007.

<sup>6</sup> "Malaysia Defends State Despite U.S. Threat to Halt FTA Talks," *Bernama - Malaysian* (continued...)

also was firm on the issue, “We reject the pressure being inflicted upon us ... Do not bring any political matters into trade.”<sup>7</sup> In an official statement on February 6, MITI repeated Malaysia’s objections to Representative Lantos’ comments, stating:

The call by Tom Lantos to suspect the free trade agreement negotiations because of a business deal by a Malaysian company with the National Iranian Oil company does not augur well for the negotiations.... Malaysia reiterates that the FTA negotiations cannot be held hostage to any political demand, and cannot be conducted under such threats. Malaysia is also ready to suspend negotiations if the situation warrants it.<sup>8</sup>

Further complicating the negotiations is the possible end to Trade Promotion Authority.<sup>9</sup> The Bush Administration has indicated its preference to conclude the negotiations of the FTA with Malaysia in time for its consideration under the terms of Trade Promotion Authority, implying an effective deadline of March 31, 2007. However, Malaysia has repeatedly stated that it does not consider itself bound by the U.S. deadline, and is willing to continue talks beyond March 31, 2007. Whether or not the negotiations are concluded by the U.S. deadline, any FTA with Malaysia will have to be approved by Congress under the authority granted by Article 1, Section 8 of the U.S. Constitution.

## **Islam Hadhari**

Under the leadership of Prime Minister Abdullah Badawi Malaysia has been developing a concept, “Islam Hadhari,” that seeks to promote a moderate or progressive view of Islamic civilization.<sup>10</sup> Prime Minister Abdullah Badawi stated that “we are responsible for ensuring that the culture of extremism and violent acts in the name of Islam does not happen in Malaysia.”<sup>11</sup> Some observers believe that Islam Hadhari could promote a view of Islam that encourages and emphasizes development, social justice and tolerance.<sup>12</sup> Increasing attention appears to be focused on the role that moderate Islamic ideology and moderate Islamic states can play in countering the forces of Islamic extremism within the region and beyond. Some

<sup>6</sup> (...continued)

*National News Agency*, February 2, 2007.

<sup>7</sup> “Malaysia Stands by Iranian Gas Deal,” *BBC News*, February 2, 2007.

<sup>8</sup> “Statement by the Ministry of International Trade and Industry on US Congressman Tom Lantos Request to Suspend Malaysia-US FTA Negotiations,” February 6, 2007.

<sup>9</sup> For a more detailed discussion of Trade Promotion Authority, see CRS Report RL33743, “Trade Promotion Authority (TPA): Issues, Options, and Prospects for Renewal,” by J. F. Hornbeck and William H. Cooper.

<sup>10</sup> Transcript of Interview with the Prime Minister of Malaysia,” *Bernama*, February 17, 2005.

<sup>11</sup> “Malaysian Premier calls on Muslims to Defy Militants,” *Agence France Presse*, July 20, 2005.

<sup>12</sup> Paul Wiseman, “In Malaysia Islamic Civilization is Promoted,” *USA Today*, November 4, 2004. Evelyn Goh, “Keeping Southeast Asia on the U.S. Radar Screen,” *PacNet Newsletter*, May 26, 2005.

analysts are concerned about what they see as an “increasing Islamisation trend in Malaysia” and that “a more conservative form of Islam is emerging” in Malaysia despite government efforts through Islam Hadhari to “pave the way for the development of Malaysia as a bastion of Islamic moderation.”<sup>13</sup>

## Political Dynamics

The next general election in Malaysia is due in 2009. Some observers believe Prime Minister Abdullah Badawi may call an early election. The decision by the leading party in the ruling Barisan National (BN) Coalition, the United Malays National Organization (UMNO), to postpone its 2007 party elections has been interpreted by some as a move to bolster party unity in the lead up to a general election. Key observers have also pointed to decisions by Parti-Islam sa-Malaysia (PAS), Parti Keadilan Rakyat, and the Democratic Action Party (DAP) to boycott by-elections, despite their differences, as a possible sign of closer cooperation between key opposition parties in the lead up to the next general election. Prime Minister Badawi’s government has been beset by division within UMNO. These are based on differences between former Prime Minister Mahathir Muhammad and Prime Minister Badawi. It is thought that these divisions will lead Abdullah Badawi to early general elections as he may seek a fresh mandate to reinforce his position within his party.<sup>14</sup>

On October 31, 2003, former Prime Minister Mahathir Mohamad turned over power to his former Deputy Prime Minister Datuk Seri Abdullah Badawi,<sup>15</sup> ending 22 years of rule by Mahathir. Prime Minister Abdullah Badawi met with President Bush on July 19, 2004, during a three-day visit to the United States. Badawi’s visit sought to further strengthen the bilateral relationship between Malaysia and the United States following this important transfer of political leadership.<sup>16</sup> While Badawi has not refrained from criticizing United States’ policies, particularly on Iraq and the Middle East, he has done so in a relatively diplomatic manner as compared to his predecessor.<sup>17</sup> Malaysian Foreign Minister Syed Hamid Albar reportedly stated that Badawi would “exchange views on how we can deal with Islamic issues, how we can avoid the perception of prejudice, [and the] perception of marginalization of Muslims.”<sup>18</sup> Though Malaysia has opposed the U.S.-led wars in Afghanistan and Iraq, it is considered a valuable ally in the war against terror in Southeast Asia.

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<sup>13</sup> Mohamad Nawab Mohd Osman, “Where to Islam Hadhari?” *IDSS Commentaries*, November 28, 2006.

<sup>14</sup> “Malaysia: Country Report,” *The Economist Intelligence Unit*, February 2007.

<sup>15</sup> Michael Vatikiotis, “Farewell Dr. M.,” *Far Eastern Economic Review*, 9 October 2003.

<sup>16</sup> Malaysian Prime Minister to Meet with U.S. President 19 July,” *BBC Monitoring Asia Pacific*, July 6, 2004.

<sup>17</sup> “Malaysia’s Quiet Revolution Wins Friends Abroad,” *Agence France Presse*, July 7, 2004.

<sup>18</sup> “Malaysian Leader to Tell Bush Terrorism Has Increased,” *Associated Press*, July 9, 2004.

Badawi has also focused on strengthening already strong bilateral trade and investment ties between the United States and Malaysia.<sup>19</sup>

During his 2004 visit to Washington, Prime Minister Abdullah Badawi and President Bush reportedly discussed the need to move the bilateral relationship forward and rebuild confidence. Prime Minister Badawi reportedly told the president that “we need to find the moderate center, we must not be driven by extremist impulses or extremist elements … we need to bridge the great divide that has been created between the Muslim world and the West.”<sup>20</sup> During Badawi’s visit, President Bush expressed his opinion that “the United States and Malaysia enjoy strong bilateral ties, ranging from trade and investment relationships to defense partnerships and active cooperation in the global war on terrorism. As a moderate Muslim nation, Malaysia offers the world an example of a modern, prosperous, multi-racial, and multi-religious society.”<sup>21</sup>

The transition from Mahathir to Badawi was consolidated in the March 21, 2004 elections that expanded the ruling Barisan National (BN) coalition’s hold on parliament from 77% to 90% of the seats. Prime Minister Badawi heads the United Malays National Organization (UMNO), the key party in the Barisan National coalition. The BN coalition also includes parties representing the minority ethnic Chinese and Indian communities. Barisan National also increased its share of votes from 57% to 64%.<sup>22</sup> The main opposition party, the Pan-Malaysia Islamic Party (PAS), which has an Islamist agenda, lost voter confidence, including in its area of traditional support in northeast peninsular Malaya.<sup>23</sup> The government’s coalition now controls 11 of 12 state governments. The election has been viewed by observers as a vote of confidence by Malaysians in Badawi’s relatively moderate form of Islamic practice as opposed to the hard-line approach of PAS.<sup>24</sup>

Malaysia’s political disposition is of interest to U.S. policy makers for a number of reasons, including the potential moderate role that Malaysia could play in the Islamic world. Malaysia is a moderate, majority Muslim state that can play a constructive role in the struggle against militant Islamic extremism despite its sometimes anti-Western and anti-Jewish rhetoric. Malaysia condemned the attacks of September 11, 2001 and has supported the campaign against terrorism. Malaysia, a state where Islam is the official religion, is seeking to play a larger international

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<sup>19</sup> “Abdullah’s Leadership Style Gets Positive Response From Leaders,” *Bernama Daily*, July 9, 2004.

<sup>20</sup> Speech by The Honourable Abdullah Ahmad Badawi, Prime Minister of Malaysia, Dinner Hosted by the U.S.- ASEAN Business Council, Washington, DC July 19, 2004.

<sup>21</sup> President Bush, Written Remarks to the U.S. ASEAN Business Council Dinner honoring Prime Minister Badawi, July 19, 2004.

<sup>22</sup> “Malaysia’s Election: Bravo Badawi,” *The Economist*, March 27, 2004.

<sup>23</sup> The term “Islamist” is used to identify those who would affiliate themselves with more extreme interpretations of Islam.

<sup>24</sup> See Anthony Smith, “Malaysia’s 2004 Elections: Mahathir’s Successor Succeeds,” *Asia Pacific Security Studies*, April 5, 2004 and “So Much for the New Broom,” *The Economist*, April 3, 2004.

role through such organizations as the 57-member Organization of the Islamic Conference (OIC), Non-Aligned Movement (NAM), and the Association of Southeast Asian Nations (ASEAN).<sup>25</sup> While Malaysia may be able to exert a moderate influence in the Islamic world, and particularly with the Islamic community in Southeast Asia, its impact among Arab states is thought to be limited despite Malaysia's potential as a model of development for less developed Muslim states. (See CRS Report RS21903, *Islam in South and Southeast Asia*, by Bruce Vaughn for more information.) Southeast Asian Islamic populations in Indonesia, Malaysia, Brunei (and to a lesser extent in the Philippines, Thailand, Burma and Singapore) constitute a third of the world's Islamic population and are experiencing a spiritual, social, and cultural revival at a time when there is also increased radicalization among some groups in the region as demonstrated by the terrorist group Jemaah Islamiya (JI) and Abu Sayaf.<sup>26</sup>

## Historical Context

Many of the political cleavages of Malaysian society, which continue to have relevance to today's political dynamics, find their root in Malaysia's colonial past. Malaysia inherited a diverse demographic mix from the British. Through the importation of labor, the British added ethnic Chinese and Indians to the Malay and other indigenous populations of peninsular Malaya, Sabah, and Sarawak. The demographic composition of Sabah and Sarawak includes a higher percentage of indigenous groups, such as the Iban. Malays and other indigenous groups are known as Bumiputeras, or "sons of the soil." Together they comprise some 58% of the population as opposed to the Chinese (24%) and Indian (7%) groups. Traditionally, ethnic Chinese and Indians have controlled a disproportionately greater share of the nation's wealth than Bumiputeras.

Malaysia has a complex history of inter-communal politics. The Malaysian Union created by the British Labor Government after World War II provided for common citizenship regardless of ethnicity. Fears among the Malays that they could not compete with the more commercially-minded Chinese led to the creation of the Federation of Malaya in 1948, which was biased in favor of the Bumiputeras. Sabah and Sarawak joined Malaya to form Malaysia later in 1963, while Singapore left the Federation in 1965. At independence in 1957, there was an understanding that Malays would exert a dominant position in political life in Malaya, while ethnic Chinese and Indians would be given citizenship and allowed to continue their role in the economy.<sup>27</sup>

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<sup>25</sup> "Mahathir's Unity-Through Oil Proposal Underscores OIC Weakness," *Stratfor*, October 3, 2002.

<sup>26</sup> S. MacDonald and J. Lemco, "Political Islam in Southeast Asia," *Current History*, November, 2002. For additional information, see CRS Report RL31672, *Terrorism in Southeast Asia*, coordinated by Bruce Vaughn.

<sup>27</sup> Harold Crouch, *Government and Society in Malaysia*, (Ithica: Cornell University Press, 1996), p. 157.

This accommodation between groups has not always been tranquil. Between 1948 and 1960, the Communist Party of Malaysia, which was largely comprised of ethnic Chinese, waged a guerilla war against the British. This came to be known as the Malayan Emergency.<sup>28</sup> The Internal Security Act (ISA), which continues to be used to suppress groups that threaten the regime, originally was put in place by the British to combat communist subversion. The Special Branch, which Malaysia inherited from the British, continues to act as the primary intelligence and security unit under the Royal Malaysian Police. During The Emergency, Malays generally sided with the British against the communists whose ranks were drawn largely from the Chinese community. By the mid 1950s, the insurrection had collapsed. Added to this history of inter-communal strife were the riots of 1969 in which approximately 200 were killed. Most of those killed were ethnic Chinese. Malaysia's turn towards more authoritarian government can also be traced to 1969, when Parliament was suspended and an emergency was declared.<sup>29</sup>

The New Economic Policy (NEP), instituted in 1971 following the 1969 riots, provided preferential treatment for the Bumiputera majority via a kind of quota system in order to increase their share of the economic wealth of the country. The New Development Policy (NDP) replaced the NEP in 1990. The NDP retained NEP goals, such as 30% Bumiputera control of corporate assets. Prime Minister Mahathir's subsequent *Vision 2020* policy has similar elements, but is more inclusive and does more to foster national ethnic unity.<sup>30</sup> Malaysia appears to be dependent on an expanding economy to be able to disproportionately favor Bumiputeras while not undermining the economic position of ethnic Chinese and Indian groups in absolute terms. In this way, Malaysia's social harmony may be linked to economic growth. For this reason, periods of economic stagnation could carry the prospect of eroding the delicate balance between ethnic groups in Malaysia.

## Internal Politics

Malaysia is a Constitutional Monarchy, but of an unusual kind, whose structure includes 13 states and three federal territories. Every five years, the nine hereditary Sultans elect one from among their group to be the Yang di Pertuan Agong, a traditional title equating to a King. The Agong exercises limited authority and acts on the advice of the Prime Minister, Parliament and the Cabinet. The Prime Minister is the head of the Federal Government, which has 25 ministries. Out of a total of 13 states four are ruled by State Governors appointed by the Federal Government. In the nine other states, the hereditary Sultan fulfills this function. Each state has a state legislature. The lower house of Malaysia's Parliament, the Dewan Rakyat, has 193 members elected for terms not to exceed five years. The upper house, the Dewan

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<sup>28</sup> Lt. General David Patraeus has reportedly studied the Malaya Emergency, among other counterinsurgency operations, as he has prepared himself for operations in Iraq. Dan Murphy, "New Commander, New Plan in Iraq," *Christian Science Monitor*, February 9, 2007.

<sup>29</sup> Crouch, p.26.

<sup>30</sup> YAB Dato' Seri Dr. Mahathir Mohamad, *Vision 2020*, (Kuala Lumpur: Institute of Strategic and International Studies, 1991).

Negara, has 43 members appointed by the King and 26 elected members with two from each state.

Malaysia is an “ambiguous, mixed”<sup>31</sup> or “semi”<sup>32</sup> democracy that has both democratic and authoritarian elements. The constitution is largely democratic and provides for regular elections that are responsive to the electorate. The government is based on a parliamentary system, and the judiciary is designed to be independent. Despite this democratic structure, authoritarian control limits the ability of the opposition to defeat the ruling coalition at the polls.<sup>33</sup> The ruling coalition is known as the Barisan Nasional, or the National Front. It includes the United Malays National Organization (UMNO), the Malaysian Chinese Association (MCA), and the Malaysian Indian Congress (MIC). The opposition Barisan Alternatif (BA) includes Party Islam Se-Malaysia (PAS), the National Justice Party (NJP), and the Malaysian Peoples Party (PRM). UMNO represents mainstream ethnic Malay interests and is the most influential party in Malaysia today despite the *reformasi* challenge mounted by former Prime Minister Mahathir’s former Deputy Prime Minister Anwar Ibrahim in the 1999 elections, at which time Malay support for UMNO is thought to have dropped from around 60% to around 40%.<sup>34</sup> The Malaysian administration, under both Prime Minister Mahathir and Prime Minister Badawi, has promoted a moderate form of Islam under a secular polity while opposing the rise of Islamic extremists whose policies are more closely associated with PAS.<sup>35</sup> The ruling Barisan National Front, under Mahathir’s leadership, used the power of the state, including the ISA, to thwart political gains by PAS, which advocates a more conservative and less modern view of Islam. PAS’s influence is traditionally found in the northeast states of Kelantan and Terengganu.<sup>36</sup>

## Political Transition

The political transition from Mahathir to Badawi led to the improvement of U.S.-Malaysian relations. Prime Minister Abdullah Badawi is Malaysia’s fifth Prime Minister. Some feel Badawi, who was first elected to Parliament in 1978, has had to strike a balance between providing continuity of leadership to produce stability, and meeting expectations for a more open and consultative style of government. Badawi pledged to work with the Barisan Nasional to realize the policy goals articulated in

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<sup>31</sup> Crouch, pp. 4-5.

<sup>32</sup> William Case, “Malaysia’s General Elections in 1999: A Consolidated and High-Quality Semi-Democracy,” *Asian Studies Review*, March, 2001.

<sup>33</sup> Crouch, p. 5.

<sup>34</sup> Bridget Welsh, “Real Change? Elections in the Reformasi Era,” in E. T. Gomez, *The State of Malaysia: Ethnicity, Equity and Reform*, (London: Routledge Curzon, 2003)

<sup>35</sup> For a more detailed discussion of these dynamics see William Case, “Deep Insecurity and Political Stability: Inside Mahathir’s Malaysia,” in Bruce Vaughn ed. *The Unraveling of Island Asia?* (Westport: Praeger Publishers, 2002).

<sup>36</sup> S. Jayasankaran, “Lost Ground,” *Far Eastern Economic Review*, March 21, 2002.

*Vision 2020.*<sup>37</sup> It is thought that Badawi's political legitimacy will at least in part be dependent on his ability to deliver sound economic growth and to counter the perceived rise of Islamic extremism in Malaysia.<sup>38</sup> Badawi's respected religious background<sup>39</sup> has helped him counter the rising popularity of PAS and the forces of Islamic extremism.

## Malaysia's International Relations

Malaysia has been playing an active role in international organizations both in its region and beyond. Besides Asia Pacific Economic Cooperation (APEC), ASEAN, and the World Trade organization (WTO), Malaysia is also a member of the Asian Development Bank (ADB), the Islamic Development Bank, the Non-Aligned Movement (NAM), Organization of Islamic Conference (OIC), the United Nations, and the World Bank. In 2006, Malaysia Chaired ASEAN, the Organization of Islamic Conference (OIC), and the Non-Aligned Movement (NAM). Malaysia has been an active contributor to international peacekeeping, including most recently in East Timor. It also sent personnel to assist the Aceh Monitoring Mission in Indonesia. Malaysia has also been seeking to facilitate negotiations between the government of the Philippines and the Moro Islamic Liberation Front.<sup>40</sup>

Malaysia has placed much emphasis on regional cooperation despite its differences with regional states. In the past, Malaysia and the Philippines have differed over the Philippines' claim to parts of Sabah. Indonesia and Malaysia came into conflict as a result of Indonesian military raids over the border in Borneo in 1963. These were part of its policy of *confrontasi* and repelled by Malaysian and Commonwealth forces. Malaysia remains a member in the Five Power Defense Arrangements along with Australia, New Zealand, the United Kingdom, and Singapore, which has its roots in Malaysia's colonial past. Malaysia was a founding member of ASEAN in 1967 and in the 1990s was a strong advocate for expanding ASEAN to include Burma, Laos, and Vietnam. It has been an active member of the Non-Aligned Movement, the OIC, and the Commonwealth.

Malaysia has also sought to play a more influential role in ASEAN. Malaysia hosted the East Asian Summit in Kuala Lumpur in December 2005. (For additional information see CRS Report RL33242, *East Asia Summit (EAS): Issues for Congress*, by Bruce Vaughn.) Malaysia has ongoing disputes with Singapore over the supply

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<sup>37</sup> "Abdullah Pledges to Work Hard to Make Vision 2020 a Reality," *New Straits Times*, September 8, 2003.

<sup>38</sup> Bridget Welsh, "Elite Contestation, Political Dilemmas and Incremental Change," Woodrow Wilson Center, July 24, 2003.

<sup>39</sup> Badawi's father and grandfather were Islamic religious scholars. Badawi himself has a degree in Islamic Studies.

<sup>40</sup> "The United States and Malaysia: A Diverse and Expanding Partnership," U.S. Department of State, Bureau of Public Affairs, July 26, 2006.

of water to Singapore.<sup>41</sup> Malaysia's relatively small size and a lack of consensus in ASEAN to follow a Malaysian lead, place limits on the extent to which Malaysia can assume a leadership role within ASEAN and the region.

Malaysia has significant interest in the hydrocarbon potential of the South China Sea. This has put Malaysia in conflict with Brunei over the Baram Delta off the coast of Sabah and Sarawak. In July 2002, independent U.S. contractor Murphy Oil, working for Malaysia's state oil company Petronas, discovered the Kikeh field, which is estimated to hold 700 million barrels of oil.<sup>42</sup> This represents 21% of Malaysia's current reserves, which are projected to run out in 15 years.<sup>43</sup> Malaysia, China, the Philippines, and Vietnam have conflicting claims over the Spratly Islands and the South China Sea. Though continuing, this conflict has been less contentious in recent years than it was in the 1990s.

The attitudes of Malaysia and other ASEAN states towards China have undergone a significant shift over the past two decades.<sup>44</sup> Relations with China were once characterized by much suspicion. Malaysia normalized relations with China in 1974, but has maintained close economic and trade relations with Taiwan. Over 2,000 Taiwanese companies have invested in Malaysia. In 2005, while China was Malaysia's fourth largest trading partner, Taiwan was its eighth largest trading partner.

In recent years, issues of economic competition and cooperation have been more of a concern to ASEAN states than security concerns.<sup>45</sup> China currently is said to be thought of "as more of an opportunity with concomitant challenges, rather than as a threat" as it was as recently as 1999 when China fortified Mischief Reef in the South China Sea which it had occupied in 1994.<sup>46</sup> To assert its claims to the South China Sea, Malaysia constructed a concrete building on Investigator Shoal in the Spratlys in 1998. ASEAN states' perceptions could change again should China more actively reassert its claims in the South China Sea or go to war over Taiwan.<sup>47</sup>

## Malaysia-Indonesia Relations

Relations between Malaysia and Indonesia have at times been tense including differences over Malaysian policies towards illegal Indonesian workers and a

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<sup>41</sup> "Singapore Testing Our Patience with Baseless Accusations," *New Straits Times*, September 13, 2003.

<sup>42</sup> S. Jayasankaran, "Well-Oiled," *Far Eastern Economic Review*, August 28, 2003.

<sup>43</sup> S. Jayasankaran, "Oil and Water," *Far Eastern Economic Review*, July 3, 2003.

<sup>44</sup> Jane Perlez, "Asian Leaders Find China a More Cordial Neighbor," *The New York Times*, 18 October, 2003.

<sup>45</sup> Alice D. Ba, "China and ASEAN: Re-navigating Relations for a 21<sup>st</sup> Century Asia," *Asia Survey*, August, 2003.

<sup>46</sup> Rommel Banlaoi, "Southeast Asian Perspectives on the Rise of China: Regional Security After 9/11." *Parameters*, Summer, 2003.

<sup>47</sup> J. Wong & S. Chan, "China-ASEAN Free Trade Agreement," *Asian Survey*, June, 2003.

maritime dispute with implications for control of valuable energy resources off Borneo. Many undocumented Indonesians working in Malaysia were pressed to leave Malaysia in 2005. Malaysia also awarded an oil concession to Royal Dutch Shell in the waters off Sabah in northeastern Borneo that are also claimed by Indonesia. The conflict escalated to the point that both nations sent naval ships to assert their claims before diplomacy eased tensions.<sup>48</sup> Malaysia agreed to participate in the monitoring of the peace treaty signed in August 2005 between Indonesia and Gerakan Aceh Merdeka (GAM) along with the international monitoring team led by the European Union.<sup>49</sup> Malaysia has also called for ASEAN states to discuss defense issues as well as foreign and economic policy.<sup>50</sup>

Illegal forest fires in Sumatra in August 2005 led Malaysia to close schools, as well as Malaysia's largest seaport, and declare a state of emergency in Kuala Selangor and Port Kelang as smoke severely limited visibility and created a significant health risk.<sup>51</sup> Given that illegal burning of forests in Indonesia has led to dangerous smoke pollution in Malaysia before, some observers have speculated that more must be done to put in place legal frameworks to control trans-border pollution.<sup>52</sup> An estimated 70% of all logging in Indonesia is illegal.<sup>53</sup>

The Indonesian government reportedly placed the blame for the fires on 10 logging companies, of which 8 were Malaysian-owned. They apparently set the fires to clear land for palm oil plantations. The Indonesian government reportedly will prosecute the companies responsible for the illegal blazes. Indonesia has also stated that Malaysia should prosecute those companies responsible for the forest fires. Prime Minister Abdullah Badawi reportedly stated that Malaysia would act against Malaysian plantation companies involved in illegal forest fires.<sup>54</sup>

Malaysia's border with Thailand has been a source of friction in their bilateral relationship. Thailand's southern provinces are Muslim majority areas where separatist violence has been increasing. Malaysia agreed to work with Thailand under a Joint Development Strategy for border areas to develop the economy and living conditions of people in the border region. Abdullah Badawi has highlighted the need to address poverty as a means of alleviating the conflict in Southern Thailand.<sup>55</sup>

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<sup>48</sup> "Malaysia at a Glance: 2005-06," Economist Intelligence Unit, June 2005.

<sup>49</sup> "M'sia to Send Peace Monitors to Aceh," *Bernama Daily*, August 6, 2005.

<sup>50</sup> "Malaysia Says Southeast Asian Grouping Should Tackle Defence Issues," *Agence France Presse*, August 7, 2005.

<sup>51</sup> "Indonesian Fires Blanket Central Malaysia," *The New York Times*, August 12, 2005.

<sup>52</sup> "Malaysia: Pollution Levels Close Schools," *Asia Pacific Radio*, August 11, 2005.

<sup>53</sup> Jared Diamond, *Collapse: How Societies Choose to Fail or Succeed*, (New York: Viking Publishers, 2005) p. 471.

<sup>54</sup> "Malaysia Must Prosecute Cos for Haze-Indonesia," *Dow Jones*, August 14, 2005 and "Govt Vows to Prosecute 10 Firms Over Forest Fires," *The Jakarta Post*, August 16, 2005.

<sup>55</sup> "Malaysia, Thailand Prepare to Accelerate Development of Border Regions," BBC News, February 12, 2007. "Malaysia Pledges to Aid Thai Government in Ending Violent Unrest (continued...)

## Malaysia's Economy and Trade Relations

Malaysia is a relatively mature industrialized nation, whose economy relies on both domestic forces (personal consumption and private investment) and external trade for its growth and development. Following a short, severe recession in 1998 and a mild turndown in 2001,<sup>56</sup> Malaysia's real gross domestic product (GDP) has grown between 5% and 6% per year for the past five years. The current official government estimate has its real GDP increasing 5.8% in 2006 and projecting 6.0% growth in 2007 (see **Table 1**).

**Table 1. Selected Indicators for the Malaysian Economy**

|  | 2005    | 2006 (est.) | 2007 (proj.) |
|--|---------|-------------|--------------|
| Real GDP Growth  | 5.2%    | 5.8%        | 6.0%         |
| Real GDP (billion ringgits)                                  | 262.175 | 277.263     | 293.990      |
| Nominal GDP (\$ billion)                                     | 124.457 | 142.593     | 155.982      |
| Nominal GDP per Capita (\$)                                  | 4,763   | 5,353       | 5,740        |
| GDP per Capita - purchasing power parity. <sup>57</sup> (\$) | 10,614  | 11,871      | 12,666       |
| Inflation Rate - CPI   | 3.0%    | 3.7%        | n.a.         |
| Inflation Rate - PPI   | 6.8%    | 6.8%        | n.a.         |
| Unemployment Rate  | 3.5%    | 3.5%        | 3.5%         |
| Exports (\$ billion)   | 140.950 | 162.688     | 177.301      |
| Imports (\$ billion)   | 114.603 | 132.391     | 145.572      |
| Exchange rate (ringgits per U.S. dollar)                     | 3.78    | 3.50        | n.a.         |

**Source:** Malaysia's Ministry of Finance ([www.treasury.gov.my](http://www.treasury.gov.my)).

**Note:** real GDP base year 1987

Malaysia's GDP and average per capita income classify it as a middle income country according the World Bank's system, comparable to Mexico and Russia.<sup>58</sup> At

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<sup>55</sup> (...continued)

on Shared Border," Global Insight, February 12, 2007.

<sup>56</sup> The 1998 recession was precipitated by the Asian Financial Crisis (see CRS Report RL30517, *Asian Financial Crisis and Recovery: Status and Implications for U.S. Interests* by Richard Cronin for details). The 2001 downturn is generally attributed to the global economic downturn following the attacks on the Pentagon and World Trade Center (see CRS Report RS21937, *9/11 Terrorism: Global Economic Costs*, by Dick Nanto for details).

<sup>57</sup> Purchasing power parity estimates of per capita GDP attempt to revalue official GDP figures by comparing the relative costs of a select group of goods in each nation and then recalculating per capita GDP to reflect the relative purchasing power in each nation.

<sup>58</sup> For a list of the World Bank's ranking of economies by per capita income, see [<http://siteresources.worldbank.org/DATASTATISTICS/Resources/GNIPC.pdf>].

official exchange rates, the per capita income is \$5,353, but its purchasing power parity value is estimated at \$11,871.

Since the 2001 economic downturn, Malaysia's economic growth has relied on a combination of strong domestic demand and continued export growth. In 2006, the main sources of real GDP growth were (in order): domestic consumption, public investment, and private investment. Because imports grew more rapidly than exports, 10.0% compared to 7.7%, external trade actually lowered economic expansion in 2006. Government forecasts project a similar pattern of growth in 2007.

Another indication of the maturation of Malaysia's economy is its sectoral balance (see **Table 2**). While agriculture and manufacturing continue to play an important role in Malaysia's economy, the nation's GDP mainly comes from the service sectors. The sectoral structure of Malaysia's economy is more akin to those of South Korea and Thailand than Indonesia, the Philippines and Vietnam.

**Table 2. Share of Gross Domestic Product by Sector, 2005-2007**

| Sector        | 2000  | 2005  | 2006 (est.) | 2007 (proj.) |
|---------------|-------|-------|-------------|--------------|
| Agriculture   | 9.4%  | 8.2%  | 8.2%        | 8.1%         |
| Mining        | 7.2%  | 6.7%  | 6.4%        | 6.4%         |
| Manufacturing | 30.0% | 31.6% | 32.0%       | 32.2%        |
| Construction  | 3.6%  | 2.7%  | 2.6%        | 2.6%         |
| Services      | 54.3% | 58.2% | 58.2%       | 58.1%        |
| Adjustments   | 0.0%  | -7.4% | -7.4%       | -7.4%        |

Source: Department of Statistics, Malaysia

Although agriculture provides a relatively small portion of Malaysia's GDP, it plays an important role in the nation's overall economy. One out of every three Malaysians live in rural areas. Approximately one out of every eight workers in Malaysia are employed in agriculture, animal husbandry, fishing, or forestry. Rice and palm oil are two crops of particular importance to Malaysia, the former for political reasons because many Malaysian farmers are reliant on rice for their livelihood and are opposed to the import of rice. The latter is important for economic reasons, as palm oil is a traditional major export crop for Malaysia.

Malaysia's manufacturing sector accounts for nearly a third of the nation's GDP, employs about 30% of its workers, and accounts for over 80% of its export earnings. It is dominated by the production of automobiles, and electrical and electronic products.

Malaysia is a regional leader in the production of automobiles, automotive components and parts. Its two major automobile manufacturers, Proton and Perodua, export their vehicles to over 40 countries, and Malaysia's leading motorcycle manufacturer, Modenas, exports to markets around the world, including Argentina, Greece, Iran, Malta, Mauritius, Singapore, Turkey, and Vietnam. Malaysia's

automotive industry benefits from Malaysia's tariff and non-tariff trade restrictions on the import of automobiles, motorcycles, and components and parts for automobiles and motorcycles.

The electrical and electronics (E&E) industry of Malaysia is a world-leader in the production of semiconductors and the assembly of E&E products, much of which is done under contract for leading international electronics companies. Approximately half of Malaysia's export earnings come from the E&E industry. However, over half of Malaysia's imports are raw materials, components, equipment, and capital goods to be used by its E&E manufacturers. As a result, the nation's economy is somewhat dependent on the global demand for electrical and electronic products.

Malaysia's service sector is highly diversified, providing services for both the domestic and external segments of the economy. The service sector provides over 58% of the nation's GDP and more than half of its employment. Following the Asian financial crisis in 1997, Malaysia placed severe restriction on foreign participation in some service sectors, including financial services. Over the last five years, Malaysia has gradually loosened those restrictions, but access to Malaysia's financial markets is still very limited to foreign companies.

Foreign trade was a major driver of Malaysia's economic growth in the past and continues to be important for its overall economic health. According to preliminary figures, Malaysia's total trade exceeded 1 trillion ringgits for the first time in 2006. Over the last five years, Malaysia's exports increased 76.2% in value, while its imports rose by 71.55 (see **Table 3**).

**Table 3. Malaysia's Exports, Imports and Merchandise Trade Balance, 2001-2006**  
(billion ringgits & U.S. dollar)

| Year  | Exports           | Imports           | Trade Balance   |
|-------|-------------------|-------------------|-----------------|
| 2001  | 334.284 (88.202)  | 280.229 (73.866)  | 54.055 (14.336) |
| 2002  | 357.430 (93.370)  | 303.091 (79.870)  | 54.340 (13.500) |
| 2003  | 398.882 (100.113) | 317.746 (80.093)  | 81.136 (20.020) |
| 2004  | 480.740 (125.857) | 400.077 (105.297) | 80.663 (20.560) |
| 2005  | 533.788 (140.979) | 434.010 (114.626) | 99.778 (26.353) |
| 2006* | 588.949 (n.a.)    | 480.493 (n.a.)    | 108.456 (n.a.)  |

Source: Ministry of Statistic, Malaysia and Global Trade Atlas.

Note: 2006 figures in ringgits are preliminary; 2006 figures in dollars not yet available.

According to Malaysia's trade statistics, the United States was and continues to be its largest export market (see **Table 4**). For the last three years, roughly 19% of Malaysia's exports have gone to the United States. With the exception of the Netherlands and the United States, all of Malaysia's top 10 export markets are in Asia, indicating a regional export focus.

Japan is historically the largest supplier of Malaysia's imports, but the United States was a close second for the first nine months of 2006 (see **Table 5**). Outside of Germany and the United States, all of Malaysia's leading suppliers of imports are in Asia, more evidence of its regional trade focus.

Of Malaysia's largest trading partners, only China, Japan and South Korea have a merchandise trade surplus. Every other nation has a bilateral trade deficit, with the United States running the largest bilateral trade deficit.

**Table 4. Malaysia's Top 10 Export Markets**  
(billion ringgits)

| Partner       | 2004    | 2005    | 2006    |
|---------------|---------|---------|---------|
| Total Exports | 480.722 | 533.790 | 436.479 |
| United States | 90.182  | 105.033 | 82.761  |
| Singapore     | 72.176  | 83.333  | 69.306  |
| Japan         | 48.553  | 49.918  | 38.217  |
| China         | 32.143  | 35.225  | 30.939  |
| Thailand      | 22.954  | 28.723  | 23.061  |
| Hong Kong     | 28.686  | 31.205  | 22.300  |
| South Korea   | 16.839  | 17.945  | 15.799  |
| Netherlands   | 15.752  | 17.452  | 15.214  |
| Taiwan        | 17.763  | 14.813  | 11.913  |
| Indonesia     | 11.677  | 12.580  | 10.534  |

**Source:** Department of Statistics, Malaysia.

**Note:** 2006 figures through September.

**Table 5. Malaysia's Imports by Top 10 Trading Partners**  
(billion ringgits)

| Partner       | 2004    | 2005    | 2006    |
|---------------|---------|---------|---------|
| Total Imports | 399.648 | 434.030 | 358.917 |
| Japan         | 63.693  | 63.000  | 48.007  |
| United States | 57.752  | 55.918  | 46.609  |
| China         | 39.279  | 49.879  | 43.027  |
| Singapore     | 44.437  | 50.831  | 41.640  |
| Thailand      | 21.992  | 22.889  | 19.596  |
| South Korea   | 19.844  | 21.604  | 18.928  |
| Taiwan        | 21.630  | 23.973  | 18.743  |
| Germany       | 17.798  | 19.265  | 15.055  |
| Indonesia     | 15.936  | 16.566  | 14.055  |
| Hong Kong     | 10.850  | 10.797  | 9.280   |

**Source:** Department of Statistics, Malaysia.

**Note:** 2006 figures through September

## Malaysia's Current Economic Policies

The current goals for Malaysia's economic policies are to continue its strong economic growth, maintain full employment, reduce inflationary pressures, and lower the fiscal deficit. In addition, as part of its larger policy of Islam Hadhari, the government seeks to reduce poverty, improve living standards, and reduce income and wealth inequality between the nation's various ethnic groups. In particular, there is concern about the income and wealth differential between the Bumiputera and the ethnic Chinese and Indian of Malaysia.

For the period 2006 to 2010, the Malaysian government has established a set of objectives to achieve its overall economic goals as part of its Ninth Malaysia Plan.<sup>59</sup> First, it will attempt to move its production into higher value-added activities by greater investment in education. Second, Malaysia seeks to improve the quality of the Malaysian work force by promoting the values of Islam Hadahari and improving the quality of Malaysia's educational system. Third, the government will address persistent sources of both regional and ethnic economic inequality. Fourth, Malaysia will seek to eliminate poverty by 2010 and continue to improve living standards. Fifth, in order to facilitate the achievement of the preceding objectives, the Malaysia government will strengthen the quality of its government agencies.

The key macroeconomic policies for the Ninth Malaysia Plan emphasize continued growth by increasing the role of Malaysia's private sector and by attracting

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<sup>59</sup> For more details about the Ninth Malaysia Plan, see its webpage, [<http://www.epu.jpm.my/rm9/html/overview.htm>].

foreign direct investment (FDI), especially in higher value-added activities. In addition, the government will attempt to keep inflation under control. Also, there is the explicit objective of reducing the federal fiscal deficit from 3.8% of GDP in 2005 to 3.4% of GDP in 2010. Finally, having ended the peg of the ringgit to the U.S. dollar on July 21, 2005, Malaysia's central bank, the Bank Negara Malaysia, has adopted a managed float of the ringgit against several foreign currencies.<sup>60</sup>

Malaysia's stated foreign trade policy for the next five years will continue to support trade and investment liberalization. Malaysia projects the value of total trade (imports plus exports) will exceed 1 trillion ringgits (\$286 billion) by 2010. The government sees the formation of the proposed ASEAN Free Trade Area (AFTA), the trade liberalization and facilitation efforts of the Asia-Pacific Economic Cooperation (APEC), and the current efforts by the World Trade Organization (WTO) for greater liberalization of trade in goods and services as being consistent with its overall trade policy. In particular, Malaysia strongly supports ASEAN's discussions with China, Japan, and South Korea — the so-called "ASEAN+3" — about the possibility of forming an East Asian economic community. The successful conclusion of a free trade agreement with the United States would also be viewed as being consistent with its current trade policy.

## **U.S.-Malaysia Bilateral Trade**

In general, trade relations between the United States and Malaysia are dominated by the outsourcing of the production of machinery, and electronic and electrical products by multinational corporations with operations within the United States and Malaysia. This trade pattern is revealed by the cross-shipment of similarly categorized goods to and from Malaysia, as well as the sector structure of U.S. foreign direct investment (FDI) in Malaysia. Over the last five years, Malaysia's exports to the United States have grown substantially, regardless of which nation's trade statistics are used (see **Table 6**). However, U.S. exports to Malaysia have not experienced similar growth. As a result, the U.S. bilateral trade deficit with Malaysia increased between 2001 and 2005 — up \$9.4 billion according to the United States and \$3.8 billion according to Malaysia.

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<sup>60</sup> Following the Asian Financial Crisis of 1997, the value of the ringgit fell from 2.5 ringgits to US\$1, to over 4 ringgits to the US\$1. In September 1998, the Bank Negara Malaysia pegged the exchange rate at 3.5 ringgits to US\$1.

**Table 6. U.S.-Malaysia Bilateral Trade Flows, 2001-2006**  
(Billion dollars)

|                          | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|--------------------------|------|------|------|------|------|------|
| <b>U.S. Figures</b>      |      |      |      |      |      |      |
| * Exports to Malaysia    | 9.4  | 10.3 | 10.9 | 10.9 | 10.5 | 11.6 |
| * % of Total Exports     | 1.3  | 1.5  | 1.5  | 1.3  | 1.2  | 1.2  |
| * Imports from Malaysia  | 23.1 | 24.7 | 26.2 | 29.1 | 34.7 | 34.3 |
| * % of Total Imports     | 2.0  | 2.1  | 2.0  | 1.9  | 2.0  | 1.9  |
| <b>Malaysian Figures</b> |      |      |      |      |      |      |
| * Exports to U.S.        | 19.3 | 20.4 | 22.2 | 25.8 | 30.0 | 23.6 |
| * % of Total Exports     | 20.2 | 20.0 | 19.5 | 18.8 | 19.7 | 18.0 |
| * Imports from U.S.      | 12.8 | 14.2 | 13.9 | 16.5 | 16.0 | 13.3 |
| * % of Total Imports     | 16.0 | 16.4 | 15.3 | 14.5 | 12.9 | 13.0 |

**Source:** U.S. figures - Department of Commerce; Malaysian figures - Ministry of Statistics

**Notes:** U.S. 2006 figures through November; Malaysian 2006 figures through October; Malaysian figures converted into U.S. dollars at 3.5 ringgits = US\$1.

Despite the overall growth in bilateral trade, the relative importance of each other as a trading partner has declined since 2001. From Malaysia's perspective, the United States purchased 20.2% of its exports in 2001, but only 18.0% of its exports for the first 10 months of 2006. Similarly, the United States provided Malaysia with 16.0% of its imports in 2001, but just 13.0% of its imports for January to October 2006. For the United States, Malaysia was the supplier of 2.0% of its imports in 2001 and 1.9% of its imports for 2006 through November, and was the buyer of 1.3% of its exports in 2001 and 1.2% of its exports for the first 11 months of 2006.

Table 7 lists the top by categories of goods traded between Malaysia and the United States for first 11 months of 2006. The data reveals considerable reciprocal trade in machinery (HS84), electrical machinery (HS85), and optical and medical instruments (HS90). Much of this cross trade is due to outward processing of electronic and electrical products in Malaysia by major U.S. companies.

**Table 7. Top Five U.S. Exports to and Imports from Malaysia, 2006**  
(in million dollars)

| Exports                            |           | Imports                            |            |
|------------------------------------|-----------|------------------------------------|------------|
| Commodity                          | Value     | Commodity                          | Value      |
| Electrical Machinery (85)          | 6,614.866 | Machinery (84)                     | 13,779.114 |
| Machinery (84)                     | 1,551.723 | Electrical Machinery (85)          | 13,755.335 |
| Aircraft & Spacecraft (88)         | 789.582   | Furniture & Bedding (94)           | 913.299    |
| Optical & Medical Instruments (90) | 766.512   | Rubber (40)                        | 786.122    |
| Special Products (98)              | 213.245   | Optical & Medical Instruments (90) | 708.345    |

In the bilateral exchange of machinery, the United States and Malaysia are shipping back and forth mostly computers and related equipment (HS8471) and parts and accessories for office equipment (HS8473). Similarly, trade of optical and medical equipment is mostly reciprocal shipment of oscilloscopes and other electronic measuring devices (HS9030). In the exchange of electronics and electrical products, the United States exports mostly integrated circuits and microassemblies (HS8542) and imports telephones and telephone parts (HS8517), integrated circuits and microassemblies, and transmission apparatus for radiotelphony, radiotelegraphy, television cameras, video recorders and still image cameras (HS8525).

Since 2000, the United States has consistently been among the leading sources of foreign direct investment (FDI) in Malaysia, along with Hong Kong, Japan, and Singapore. In 2005, the United States invested 1.637 billion ringgits (\$468 million) in Malaysia, which was 22.0% of Malaysia's total inward FDI for the year.<sup>61</sup> For the first nine months of 2006, U.S. FDI in Malaysia totaled 1.560 billion ringgits (\$446 million), or 18.9% of total FDI. The cumulative value of U.S. FDI in Malaysia is over \$20 billion, with much of it being invested in electronics and electrical manufacturing.

## **Malaysia and U.S. Trade Relations**

Malaysia and the United States currently hold similar positions on international trade relations. Both nations support the general concept of trade and investment liberalization and facilitation. Also, both are actively pursuing trade and investment liberalization via multilateral and bilateral fora. However, on specific issues, there are differences between the United States and Malaysia on the goals and means of obtaining those goals. As a result, the two nations sometimes share the same view on trade issues, and sometimes have different, and even, opposing views.

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<sup>61</sup> Source of FDI data: Bank Negara Malaysia [<http://www.bnm.gov.my/>].

Since Malaysia and the United States are members of the World Trade Organization (WTO), there is a shared “baseline” for their bilateral trade relations. For example, both nations grant the other nation “normal trade relations,” or NTR, status as required under the WTO. Also, since Malaysia and the United States are both members of the Asia-Pacific Economic Cooperation (APEC), they are both committed to APEC’s Bogor Goals of open trade and investment in Asia by 2020.<sup>62</sup> In addition, the United States and Malaysia concluded a trade and investment framework agreement (TIFA) in May 2004, are currently negotiating a free trade agreement (FTA), and are parties to various regional trade associations that are considering multilateral trade and investment agreements.

**U.S.-Malaysia TIFA.** On May 10, 2004, Malaysia and the United States signed a bilateral trade and investment framework agreement.<sup>63</sup> The U.S.-Malaysia TIFA states that both parties desire to develop trade and investment between the two countries, ensure that trade and environmental policies are supportive of sustainable development, and strengthen private sector contacts. To achieve these goals, the TIFA establishes a Joint Council on Trade and Investment, jointly chaired by Malaysia’s Minister of International Trade and Industry and the U.S. Trade Representative, that is to meet at least once a year for the purpose of implementing the TIFA.

The U.S.-Malaysia TIFA also sets out a two-part work program. The first part commits both nations to consultation on trade and investment liberalization and facilitation, with explicit consideration to trade in services, information and communications technology, biotechnology, and tourism. The second part stipulates that the United States and Malaysia will “examine the most effective means of reducing trade and investment barriers between them, including examination and consultations on the elements of a possible free trade agreement.”

## World Trade Organization (WTO)

Both the United States and Malaysia have been members of the World Trade Organization, or WTO, since its creation on January 1, 1995. While the United States is generally seen as being a consistent supporter of trade and investment liberalization, Malaysia’s trade policy has undergone significant changes over the last 12 years. However, under the Bawadi Administration, Malaysia has generally been supportive of trade and investment liberalization.

For the current Doha Round, the United States and Malaysia are in general agreement on the overall goals of the talks, but have differed on some of the specifics. In particular, Malaysia joined its fellow ASEAN members in pushing the United States and the European Union to improve their market access offers for

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<sup>62</sup> For more information about APEC and its Bogor Goals, see CRS Report RL31038, *Asia Pacific Economic Cooperation (APEC) and the 2006 Meetings in Hanoi, Vietnam*, by Michael F. Martin.

<sup>63</sup> The full text of the TIFA is available at the U.S. Trade Representative’s website at [[http://www.ustr.gov/assets/Trade\\_Agreements/TIFA/asset\\_upload\\_file922\\_10023.pdf](http://www.ustr.gov/assets/Trade_Agreements/TIFA/asset_upload_file922_10023.pdf)].

agricultural goods, including “making substantial reductions in trade distorting domestic support by the major players.”<sup>64</sup>

## **Asia-Pacific Economic Cooperation (APEC)**

The Asia-Pacific Economic Cooperation (APEC) group is another multilateral forum where the United States and Malaysia are both founding members. While Malaysia and the United States accept APEC’s Bogor Goals for trade and investment liberalization by 2020, as well as APEC’s “open regionalism” approach, there have been some differences of opinion on the future of APEC.<sup>65</sup> During the 2006 APEC meetings, The United States proposed the transformation of APEC into a Free Trade Area of the Asia-Pacific, or FTAAP. This proposal received a mixed response from other APEC members. Many observers believe that Malaysia prefers the formation of an all-Asian free trade area that would exclude the United States.

## **Association of Southeast Asian Nations and the East Asia Summit**

Malaysia is a founding member of the Association of Southeast Asian Nations (ASEAN). ASEAN currently has 10 members; the United States is not a member.<sup>66</sup> East Timor has applied to become ASEAN member.

During its most recent summit in Cebu, ASEAN invited Australia, India, Japan, New Zealand, the People’s Republic of China, and South Korea to attend as part of the second East Asia Summit (EAS). The first EAS was held in Kuala Lumpur in December 2005.<sup>67</sup>

One of the major items of discussion during the second EAS was the possible formation of an all-Asian free trade area. To some observers, Malaysia’s support for the EAS is a continuation of Mahatir’s East Asian Economic Caucus and its predecessor, the East Asian Economic Group. According to one source, the goal of forming an all-Asian free trade area was endorsed after overcoming China’s reluctance to include Australia and India.<sup>68</sup> An attempt to forge a similar agreement during the 2005 East Asia Summit was unsuccessful.

The possible creation of an all-Asian free trade area is seen by some observers as a response to the growing influence of the European Union and the United States

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<sup>64</sup> “Statement on the Doha Development Agenda of the WTO,” January 13, 2007.

<sup>65</sup> For more information on APEC, see CRS Report RL31038, *Asia Pacific Economic Cooperation (APEC) and the 2006 Meetings in Hanoi, Vietnam*, by Michael F. Martin.

<sup>66</sup> The current ASEAN members are: Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar (Burma), Philippines, Singapore, Thailand, and Vietnam.

<sup>67</sup> For more information about the first EAS Summit, see CRS Report RL 33242, “East Asia Summit (EAS): Issues for Congress,” by Bruce Vaughn.

<sup>68</sup> “Asian Leaders Plan Free-Trade Area from India to New Zealand,” by Arijit Ghosh and Francisco Alcuaz, Jr. *Bloomberg*, January 15, 2007.

in international trade relations. For the United States, the proposed all-Asian free trade area is a rival model to its proposed FTAAP.

## Other Aspects of U.S.-Malaysia Relations

Bilateral relations between the United States and Malaysia are viewed as having improved since Abdullah Badawi has come to power. In the past, the relationship suffered from what a U.S. official called “blunt and intemperate public remarks”<sup>69</sup> critical of the United States by former Prime Minister Mahathir, who generally subscribed to a view of the United States as a neo-colonial power strongly under the influence of a coterie of Zionist Jews.<sup>70</sup> In 1997, Mahathir speculated that international pressure on the ringgit was part of a Jewish plot. This caused some Members of Congress to threaten to pass a resolution calling on Mahathir to resign or apologize.<sup>71</sup> Such tensions continued in October 2003 when the United States condemned assertions made by outgoing Prime Minister Mahathir before the OIC that “Jews rule the world.”<sup>72</sup> President Bush reportedly told Prime Minister Mahathir that such comments were “wrong and divisive” in a side meeting of the Asia-Pacific Economic Conference in Thailand later in October 2003.<sup>73</sup> Such tensions have largely become part of the past since Abdullah Badawi became Prime Minister.

## Human Rights

The State Department report on human rights practices in Malaysia stated that the Malaysian government’s “human rights performance improved during the year; nevertheless, problems remained.” Among the problems remaining are: abridgement of citizens right to change their government, detentions of persons without trial, restrictions on freedom of the press, restrictions on freedom of assembly and association, ethnic discrimination, and incomplete investigation of detainee deaths. The report did point to “a major trend toward greater public and government oversight of the police … media increased criticism of government policies and officials, exposure of government corruption, and coverage of contentious debates among elected officials.”<sup>74</sup>

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<sup>69</sup> Prepared Statement of Matthew Daley, Deputy Assistant Secretary, Bureau of East Asian and Pacific Affairs, U.S. Department of State, As submitted to the Committee on International Relations House of Representatives, Subcommittee on Asia and the Pacific, March 26, 2003.

<sup>70</sup> Alan Sipress, “Malaysia Calls on Muslims to resist Jewish Influence,” *Washington Post*, October 17, 2003.

<sup>71</sup> “Malaysia,” in *Regional Surveys of the World: The Far East and Australasia*, (London: Europa Publications, 2002), p.732.

<sup>72</sup> “U.S. Slams Mahathir Remark on Jews,” *The Age*, October 17, 2003.

<sup>73</sup> “Bush-Malaysia,” *Voice of America*, 20 October, 2003.

<sup>74</sup> Bureau of Democracy, Human Rights, and Labor, Department of State, “Malaysia: Country Report on Human Rights Practices, 2005,” released March 8, 2006.

## U.S. Assistance

United States foreign assistance to Malaysia includes International Military Education and Training (IMET), Non-Proliferation Anti-Terrorist Demining and Related Programs (NADR), Anti-Terrorism Assistance (ATA), and Export Control and Related Border Security Assistance (EXBS). IMET programs with Malaysia seek to contribute to regional stability by strengthening military to military ties and familiarizing the Malaysian military with U.S. military doctrine, equipment, and management that promotes interoperability. The U.S. is a leading training partner with Malaysia at its Southeast Asia Regional Counter-terrorism Center. In 2007, the United States plans on working with Malaysia “to further enhance U.S.-Malaysia cooperation on maritime security both bilaterally and in multilateral fora.”<sup>75</sup> In August 2006, the United States also pledged \$100,000 to support the Heart of Borneo project between Malaysia, Indonesia, and Brunei that seeks to protect the environment and promote bio-diversity in 220,000 square kilometers of equatorial rainforest in central Borneo.<sup>76</sup>

**Table 8. Bilateral Assistance**  
(in thousands of dollars)

| Account | FY2004  | FY2005  | FY2006 est | FY2007 request |
|---------|---------|---------|------------|----------------|
| IMET    | \$939   | \$1,100 | \$891      | \$885          |
| NADR    | \$230   | \$2,308 | \$1,632    | \$3,465        |
| Totals  | \$1,169 | \$3,408 | \$2,523    | \$4,350        |

**Source:** State Department, *FY 2006 Congressional Budget Justification for Foreign Operations*, Released February 15, 2006. See also CRS Report RL31362, *U.S. Foreign Aid to East and South Asia: Selected Recipients*, by Thomas Lum.

## Military Cooperation

Military cooperation between the United States and Malaysia includes high-level defense visits, training exchanges, military equipment sales, expert exchanges and combined exercises. The 2007 Congressional Budget Justification for Foreign Operations states that “exposure to U.S. ideals promotes respect for human rights.” It goes on to state that “the Malaysian military has not been involved in systemic violations of human rights.”

In mid-2005, Deputy Secretary of State Zoellick and Malaysian Deputy Prime Minister Najib witnessed the renewal of an Acquisition and Cross Servicing

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<sup>75</sup> State Department, *FY 2006 Congressional Budget Justification for Foreign Operations*, Released February 13, 2006.

<sup>76</sup> “Heart of Borneo Conservation Initiative to receive U.S. Funds,” State Department, USINFO, August 2, 2006.

Agreement that provides a framework for bilateral military cooperation.<sup>77</sup> Malaysian officers train in the United States under the International Military Education and Training (IMET) program and there is a student exchange program between the Malaysian Armed Forces Staff College and the U.S. Army Staff College at Fort Leavenworth. United States troops also travel to the Malaysian Army's Jungle Warfare Training Center in Pulada. Humanitarian assistance, disaster relief, anti-piracy, and counterterrorism are areas that have been identified as areas of mutual interest. Between 15 and 20 U.S. Navy ships visit Malaysia annually. Bilateral military exercises include all branches of the service.<sup>78</sup> Malaysia has also bought significant military equipment from the United States, including F-18/D aircraft. Recent military procurement is reportedly seeking to narrow the technology gap with small, but well armed, Singapore.<sup>79</sup> Such purchases will also likely help Malaysia secure its maritime interests in the Strait of Malacca and the South China Sea.

United States warships and U.S. military personnel go to Malaysia to participate in joint Cooperation Afloat Readiness and Training exercises with Malaysia in the South China Sea. The exercise is aimed at bolstering bilateral military ties and improving the ability of the United States Navy to operate in regional waters.<sup>80</sup> In an address in Malaysia in June 2004, Admiral Fargo pointed to shared concerns over "transnational problems," including "terrorism and proliferation, trafficking in humans and drugs and piracy" and emphasized that "we have tremendous respect for sovereignty."<sup>81</sup> The United States has sent Coast Guard officers to the Marine Patrol training Center in Johor Baharu to help train Malaysian officers in maritime enforcement. Malaysia established a Maritime Enforcement Agency in 2005 to increase maritime patrols.<sup>82</sup> Over 50,000 ships a year pass through the Straits of Malacca. Some ships have been vulnerable to piracy in the 600 mile long strait. There is also concern that terrorists could seek to mount an attack against shipping in the strategically vital strait.<sup>83</sup>

After some apparent mis-communication, Malaysia and the United States reportedly have come to a mutual understanding on how best to secure the Straits of Malacca, which are territorial waters from possible terrorist acts.<sup>84</sup> An estimated 30% of world trade and half of the world's oil transits through the Straits of

<sup>77</sup> "Malaysia's Efforts Against Terror," *Bernama*, June 8, 2005.

<sup>78</sup> Huhtala, April 14, 2003.

<sup>79</sup> S. Jayasankaran, "Malaysia: Call for Arms," *Far Eastern Economic Review*, May 16, 2003.

<sup>80</sup> "U.S. Navy Task Force to Head for RP," *Manila Times*, July 14, 2004.

<sup>81</sup> Admiral Thomas Fargo, Commander, U.S. Pacific Command, Malaysia Media Roundtable, June 23, 2004.

<sup>82</sup> "24 Hour Surveillance for the Malacca Strait," *Bernama*, March 11, 2005.

<sup>83</sup> "Malaysia to Beef Up Malacca Patrols," *Agence France Presse*, February 6, 2007.

<sup>84</sup> For a discussion of threats to shipping in the strait and regional responses see Bronson Percival, *Indonesia and the United States: Shared Interest in Maritime Security*, U.S.-Indonesia Society, June 2005.

Malacca.<sup>85</sup> Testifying before the House Armed Services Committee on March 31, 2004, Admiral Thomas Fargo, Commander of the U.S. Pacific Command, identified the Straits of Malacca off Malaysia's coast as an area where there is concern that international terrorists might seek to attack shipping or seize a ship to use as a weapon. Fargo also reportedly suggested the idea that U.S. counterterrorism forces be positioned in the area to be able to deal with such a threat. This idea reportedly was announced without prior consultation with Malaysia, which reportedly responded "coolly" to the suggestion.<sup>86</sup> Malaysia reportedly prefers an arrangement, in the words of Defense Minister Najib, where "the actual interdiction will be done by the littoral states."<sup>87</sup> This approach was subsequently supported by Fargo during a visit to Malaysia, where he reportedly stated that U.S. cooperation would focus on intelligence sharing and capacity building to assist regional states in addressing the potential threat.<sup>88</sup> On July 20, 2004, Malaysia, Indonesia, and Singapore began coordinated naval patrols of the Straits of Malacca.<sup>89</sup>

## Counterterrorism Cooperation

Malaysia is regarded as an effective and cooperative regional player in the war against terrorism. Malaysia reportedly estimated that there were 465 members of JI in Malaysia in 2003.<sup>90</sup> Malaysia has detained over 110 suspected terrorists since May 2001.<sup>91</sup> The Malaysian government believes that it has effectively crippled the Kumpulan Mujahedin Malaysia (KMM), which is thought to have had close ties with the Jemaah Islamiya (JI) terrorist group. The KMM sought the overthrow of the Malaysian government and the establishment of an Islamic state over Malaysia, Indonesia and Muslim parts of Southern Thailand and Southern Philippines. Two of JI's leaders, Noordin Mohammad Top and Azahari Husin, the later now captured, are Malaysian, though Top is thought to be a fugitive in Indonesia.<sup>92</sup>

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<sup>85</sup> "Malaysia Accepts U.S. Aid, But Not Patrol, In Strait," *International Herald Tribune*, June 22, 2004 and Prime Minister of Singapore Lee Hsien Loong, "Engaging a New Asia," Washington, July 12, 2005.

<sup>86</sup> "Indonesia, Malaysia Give Cool Response to Suggestion of U.S. Troops in Malacca Strait," *Voice of America Press Release*, April 7, 2004.

<sup>87</sup> "Malaysia, United States to Discuss Security in the Straits of Malacca," *International Custom Wire*, June 6, 2004.

<sup>88</sup> See "U.S. to Render Assistance to Littoral States of Malacca Strait," *International Customwire*, June 23, 2004 and "U.S. Navy Task Force to Head for RP," *Manila Times*, July 14, 2004.

<sup>89</sup> "Indonesia: Three Nations Patrol Straits," *Stratfor*, July 20, 2004.

<sup>90</sup> Bridget Welsh, "Malaysia: Security Begins at Home," in David Wienczek and William Carpenter, *Asian Security Handbook: Terrorism and the New Security Environment*, (Armonk: M.E. Sharpe, 2005).

<sup>91</sup> Country Reports on Terrorism, 2005, United States Department of State, Released April 2006 and J. Chao, "Malaysia's War on Terror Worries Rights Advocates," *American Statesman*, Nov.10, 2002.

<sup>92</sup> Country Reports on Terrorism, 2005, United States Department of State, Released April (continued...)

The increasingly perceived comity of interests after September 11, 2001, improved the bilateral relationship. Foreign Minister Syed Hamid Albar stated in January of 2001 that Malaysia was looking forward to closer ties with the United States when President Bush assumed office.<sup>93</sup> The September 11, 2001 attacks against the United States were strongly criticized by former Prime Minister Mahathir, and the two nations subsequently began to work closely on counter-terror cooperation. Mahathir met with President Bush in Washington in May 2002, where they signed a memorandum of understanding on counterterrorism. Some Malaysian officials have, in general terms, equated the ISA with the recently enacted USA Patriot Act in America.

In May of 2002, the United States and Malaysia signed a declaration that provides a framework for counterterrorism cooperation.<sup>94</sup> Malaysia has taken a leading regional role in the war against terror by establishing a regional counterterrorism center in Kuala Lumpur that facilitates access to counter-terrortechology, information and training.<sup>95</sup> The concept for the center was announced in October 2002 following a meeting between President Bush and then Deputy Prime Minister Badawi at the APEC meetings in Mexico.<sup>96</sup> Malaysia hosted the ASEAN Regional Forum Inter-sessional Meeting on Counter-Terrorism in March of 2003.<sup>97</sup>

U.S. Coordinator for Counter-terrorism Ambassador Cofer Black emphasized the need to develop “sustained international political will and effective capacity building” to more effectively fight terrorism.<sup>98</sup> Within this context Ambassador Black made special reference to Malaysia’s contribution to the war against terror in Asia. He identified Malaysia’s opening of the Southeast Asia Regional Center for Counter-terrorism in August 2003 as a key example of counterterrorism capacity building in Asia. Other observers have questioned the degree to which the center has established its effectiveness. Prime Minister Badawi has continued Malaysia’s commitment to fight terrorism.<sup>99</sup> While attending a regional counter-terror conference in Bali, Indonesia in February 2004, then U.S. Attorney General Ashcroft reportedly stated that the United States is very satisfied with the role that Malaysia has played in

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<sup>92</sup> (...continued)

2006.

<sup>93</sup> “Looking Forward to Warmer Ties in Post-Clinton Era,” *New Straits Times*, January 10, 2001.

<sup>94</sup> “Malaysia, USA Sign Anti-terror Declaration,” *BBC Monitoring Service*, May 15, 2002.

<sup>95</sup> R. Hamsawi, “Local Funding for Anti-Terror Center,” *New Straits Times*, Aril 3, 2003.

<sup>96</sup> “Malaysia: Minister Gives Details of ASEAN Anti-terror Centre Project,” *BBC Monitoring Service*, April 2, 2003.

<sup>97</sup> See CRS Report RL31672, “Terrorism in Southeast Asia” for further information on terrorism in Southeast Asia.

<sup>98</sup> United States Department of State, *Patterns of Global Terrorism, 2003*, April, 2004.

<sup>99</sup> “Malaysia Pledges Terror Fight,” *The Wall Street Journal*, November 4, 2003.

fighting terrorism and that Malaysia has provided a good example to countries in the region.<sup>100</sup>

During an address to a regional defense conference in Singapore in June 2004, Malaysian Defense Minister Najib Tun Razak admonished the West when he stated “Let there be no doubt, there is more (terrorism) to come if we continue to ignore the need for a balanced approach to this campaign against terror.... We are concerned that powerful states may not be going about this campaign in ways that will win the hearts and minds of millions of ordinary people worldwide.”<sup>101</sup> Some observers view this exchange as highlighting differences in regional Southeast Asian states’ desires to include more “soft power” approaches to the war against terror as opposed to what they feel is an over reliance on “hard power” by the United States.

**Figure 1. Map of Malaysia**



<sup>100</sup> “U.S. Compliments Malaysia for Role in Anti-terrorism Efforts,” *Bernama Daily*, February 5, 2004.

<sup>101</sup> “Malaysia Says U.S. Needs to be More Balanced in Its War Against Terrorism,” *International Customwire*, June 6, 2004.